In The

Supreme Court of the United States

October Term, 1970

~~No. 1331~~ 70-78

Affiliated Ute Citizens of the State of Utah, Et Al.,

Petitioners,

—v.—

United States, Et Al.

On Writ of Certiorari to the United States Court of Appeals For the Tenth Circuit

BRIEF FOR THE RESPONDENT John B. Gale

Richard Clare Cahoon and
Thomas R. Blonquist
640 Kennecott Building
Salt Lake City, Utah 84111
Attorneys for Respondent
John B. Gale

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OPINIONS BELOW

The orders of the United States District Court for the District of Utah entering judgment for plaintiffs in *Reyos v. First Security Bank* (Reyos herein), and dismissing *Affiliated Ute Citizens of the State of Utah v. United States* (AUC herein) on the merits and for lack of jurisdiction are unreported. The opinions of the Court of Appeals for the Tenth Circuit reversing the judgment in *Reyos* and affirming the dismissal of *AUC* are reported at 431 F.2d 1337 and 1349, respectively (A. 576, 587).

JURISDICTION

The decisions of the Court of Appeals For the Tenth Circuit (Court of Appeals herein) were simultaneously filed on June 19, 1970 and the motions for rehearing in each case were simultaneously denied on November 14, 1970 (A. 588). A petition for rehearing *in banc* was filed in *Reyos* but was not considered (A. 3). A petition for certiorari was filed on February 9, 1971, and granted on April 19, 1971. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254 (1).

STATUTES AND REGULATIONS INVOLVED

The Ute Termination Act (Termination Act) is published at 25 U.S.C. §§ 677-677aa.

The relevant securities provisions are Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) and Rule 10b-5 adopted thereunder (17 C.F.R. 240.10b-5) (Rule 10b-5 or Rule) which both read as follows:

15 U.S.C. § 78j:

> It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange –
>
> * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5: --

> It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> (1) to employ any device, scheme, or artifice to defraud.
>
> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.
>
> in connection with the purchase or sale of any security.

QUESTIONS PRESENTED

1. What must be proven in order to recover damages in a private action based on an alleged violation of Rule 10b-5?

2. What is the proper measure of damages under a private action based on an alleged violation of Rule 10b-5?

STATEMENT OF THE CASE

This brief is submitted on behalf of the respondent, John B. Gale (herein "Gale"). While the brief of the petitioners covers two separate and distinct cases, Gale was a defendant only in *Reyos*. The complaint in *Reyos* sets forth two counts — count one based on an alleged violation of Regulation 10b-5 of the Securities and Exchange Commission (17 C.F.R., Sec. 240, 10b-5) and count two alleging that respondent First Security

Bank of Utah, N.A. (herein the "Bank") and respondent United States of America breached a fiduciary duty to the petitioners. The only count against Gale was the alleged violation of Rule 10b-5 (A. 7, 8).

Petitioners are members of the Ute Indian Tribe and reside on the Uintah and Ouray Reservation in the state of Utah. There are four hundred and ninety mixed-bloods in the tribe each of whom received 10 shares of stock in the Ute Distribution Corporation (herein UDC). Eighty-five mixed-bloods brought this suit and the rights of only the twelve "bellwether" plaintiffs are considered here. The rights of the other seventy-three will be determined based upon the decision made by this Court.

The alleged violation of Rule 10b-5 by Gale arises in connection with the sale of 122 shares of UDC stock by the twelve petitioners. At the time of the sales, Gale was an assistant manager of the Bank at its Roosevelt, Utah Office. He was notary of the public and had authority to guaranty signatures on stock certificates. Gale purchased a total of ten shares of UDC stock, five shares from Glen M. Reed (A. 474, 475) and five shares from Letha Harris Wopsock (A. 480). Gale's connection with the other sales by petitioners was limited to notarizing their affidavits and guaranting their signatures on the stock power when they sold their UDC stock. These services were performed by Gale at the request of petitioners (A. 512). While Gale only purchased ten shares of the UDC stock from two of the twelve petitioners, the Trial Court found that Gale had violated Rule 10b-5 in connection with every sale of stock by all twelve petitioners (A. 574, 575).

The Court of Appeals refused to lump all the petitioners together as the Trial Court had done and ruled that each petitioner stated a separate cause of action against each of the separate defendants (A. 583) and, therefore, ruled that Gale was

not liable to the petitioners for performing the ministerial services of notarizing and guaranting their signatures. The Court of Appeals found that Gale had purchased UDC stock from two petitioners and that he had misrepresented the prevailing market price of the UDC stock, but the Court of Appeals further found that in the transactions, the two petitioners did not rely upon the misrepresentation of Gale and, therefore, concluded that Rule 10b-5 had not been violated.

The facts of each sale made by the twelve petitioners are vital to this appeal and are, therefore, set forth in the following paragraphs. All shares of stock mentioned are shares of UDC stock and were sold pursuant to Section 243.12 of 25 C.F.R. Part 243 (Brief of Petitioner, App. XX). Pursuant to this regulation all sales of UDC stock prior to August 27, 1964, were first offered to members of the tribe.

1. GLEN M. REED

On July 8, 1964, Mr. Reed sold five shares of his stock to Gale for $350 per share. Mr. Reed was 45 years of age at the time, was a high school graduate and a veteran of the United States Army. Reed offered his stock to members of the tribe for $350 per share but no one accepted his offer. He subsequently sold to Gale. Gale did not advise Mr. Reed that he was purchasing the stock for Neal H. Phelps and Esther Phelps of Arizona, nor that they were paying him $530 per share for the stock (A. 474, 475).

Mr. Reed sold five shares of his stock on August 30, 1964, to Verl Haslem (A. 475, 476). Gale worked with Haslem at the Bank but had no connection with this transaction.

2. FRED LAROSE BURSON

Mr. Burson sold six shares of his stock to R. Earl Dillman

for two 1956 model Ford automobiles and $1,000 in cash after he had offered the shares to the tribe for $2,500 and no one had accepted his offer. Gale had no connection with this sale other than guaranting Mr. Burson's signature on the stock power. (A. 476, 477).

In December of 1963, Mr. Burson sold four of his shares to one Jack Turner for a trailer house. The shares were first offered to the tribe for a total of $2,000 but no one accepted the offer. At the time of the sale, Mr. Burson signed the stock power and affidavit in the presence of Gale at the Roosevelt, Utah branch of the Bank. The signatures on both documents were guaranteed and notarized respectively on February 10, 1964, by Gale (A. 477, 478) and this was his only connection with the sale.

3. LETHA HARRIS WOPSOCK

Mrs. Wopsock sold five shares of her stock to Clyde Murray on August 4, 1963. Gale notarized the affidavit which stated that she had received $2,500 and guaranteed her signature on a stock power. The Court found that in connection with this transaction Gale received a fifty cent notary fee which was paid to the Bank (A. 478, 479).

On or about February 24, 1964, Mrs. Wopsock transferred two shares of her stock to one Bill Hoopes for $1,400. Here again the Court found that Gale's only connection with the transaction was that he guaranteed her signature on the stock power and notarized the affidavit (A. 479, 480).

On August 28, 1964, Mrs. Wopsock sold three additional shares to Mr. Hoopes for $1,000 and her signature on the stock certificates was guaranteed by Gale (A. 479, 480).

Some time after August 27, 1964, Mrs. Wopsock sold three

shares of her stock to Gale for $350 per share. Gale did not tell her that the stock would be resold to Norval R. Johnson and Fern Johnson at a higher price. Mrs. Wopsock was, however, aware of the value of the stock, having sold two of her shares on February 24, 1964, for $700 per share. Mrs. Logan at the Uintah Ouray Agency had advised Mrs. Wopsock that the Ute Distribution stock had a value in excess of $700 but nevertheless, she sold the three shares to Gale for $350 per share (A. 479, 480). In October, 1964, she sold one share to Mr. Gale for $400 and in November, 1964, she sold an additional share to him for $350 (A. 480).

4. LOUISE ALLEN CASE

On November 6, 1963, Mrs. Case sold five shares to LaVere Labrum for a 1957 Ford automobile and $1,700. She had previously offered the shares for sale at the Uintah Ouray Agency on September 9, 1963, for $2,500 and no acceptance of the offer was received. On November 6, 1963, she signed the stock power and the affidavit in the presence of Gale at which time he guaranteed and notarized the signatures upon the respective documents. The Trial Court found that Gale received nothing for his services except a fifty cent notary fee which was paid to the Bank (A. 481, 482).

Later Mrs. Case sold three shares to Richard Murray for $440 per share. She had offered five shares for sale at the Uintah and Ouray Agency for $2,500 but no one had accepted her offer. The Court found that Gale had guaranteed and notarized the signatures of Mrs. Case on an affidavit and a stock power which were dated May 7, 1964. The Trial Court also found that the affidavit and stock power were signed in blank and later notarized by Gale. There is no evidence that Gale received anything from the transaction.

In June of 1964, Mrs. Case sold two shares to Dick E.

Bastion for $800 after the shares were offered for sale to members of the tribe and no one had accepted the offer (A. 482, 483). There is no evidence that Gale was aware of this transaction.

6. MELVIN REED

Mr. Reed sold ten shares of stock to one Richard Murray for a 1959 Cadillac and approximately $505. The ten shares had been offered for sale for the sum of $6,500 at the Uintah Ouray Agency on September 27, 1963. No acceptance of the offer was received. On March 11, 1964, Mr. Reed executed both a stock power and an affidavit; both were blank forms at the time they were signed and both were later guaranteed and notarized, respectively, by Gale. In reply to Gale's question of whether Reed had gotten the money the latter said "everything went square" (A. 485). The Trial Court did not find that Gale participated in this transaction in any manner other than to notarize and gurantee the signature of Mr. Reed (A. 484, 485).

7. MARGUERITE MURRAY HENDRICKS

November 5, 1963, Mrs. Hendricks sold five shares to Clyde R. Murray for a 1962 Comet automobile. These shares had been offered to the full blood Indians for $700 per share but no one had accepted her offer. Mrs. Hendricks signed a stock power and her signature was guaranteed by Gale. The Court stated that "Gale did not participate in the sales transactions except as in these findings otherwise indicated" (A. 487, 488).

On February 18, 1964, she sold five shares of stock to Richard Murray in exchange for real property in Leola, Utah. She signed a stock power and an affidavit which were dated February 18, 1964. Her signatures were notarized and guaran-

teed by Gale. The Court notes that Gale did not participate in the transaction and received only a fifty cent notary fee which was paid to the Bank (A. 487, 488).

8. JOSEPH ARTHUR WORKMAN

Mr. Workman, on or about February 10, 1964, sold six shares of stock to Robert Huish for $3,000. At the time of the sale, he signed an affidavit and a stock power before Gale who notarized Mr. Workman's signature on the affidavit and guaranteed his signature on the stock power. Gale had no other contract with this transaction (A. 489, 490).

On November 27, 1964, Workman sold one share of stock to Verl Haslem for $350. Gale had absolutely nothing to do with this transaction (A. 490).

The Trial Court found that Workman had been a member of the Board of Directors of the Affiliated Ute Citizens and that he knew and understood that his Ute Distribution Corporation stock represented an interest in the tribal minerals (A. 490, 491).

9. LEONARD RICHARD BURSON

On or about November 6, 1963, Mr. Burson sold ten shares of stock to LaVere Labrum for a 1964 automobile and $3,200 cash. Gale guaranteed Burson's signature on the stock power. The Trial Court found that Gale did not participate in the sale and received nothing from the transaction except the notary fee of fifty cents which was paid to the Bank (A. 491).

10. ORIN F. CURRY

On February 14, 1964, Mr. Curry sold one share to John Chasel and on February 19, 1964, he sold one share to Orin

Swain; both were sold for approximately $85 and automobile repairs valued at $400. Gale notarized the affidavit and stock powers which were signed by Mr. Curry. The Trial Court found that Gale did not participate in the sale transaction and received nothing but a fifty cent notary fee which was paid to the Bank (A. 491-493).

On March 24, 1964, Mr. Curry sold three shares to one Clyde R. Murray for approximately $1,800 cash. On the date of sale he executed the stock power and affidavit before Gale, who guaranteed his signature and notarized the affidavit. The Trial Court found that Gale did not participate in the sale transactions and received nothing but a fifty cent notary fee which was paid to the Bank (A. 491-493).

On March 24, 1964, Mr. Curry sold three shares to one Clyde R. Murray for approximately $1,800 cash. On the date of sale he executed the stock power and affidavit before Gale who guaranteed his signature and notarized the affidavit. The Trial Court found that Gale did not participate in the sale transactions and received nothing but a fifty cent notary fee which was paid to the Bank (A. 493).

On or about August 18, 1964, Mr. Curry sold two shares of stock to Dick Bastion for $300 per share. On the date of the sale, his signature was guaranteed on the stock power by Gale. The Trial Court found that except as in these findings indicated, Gale did not participate in the sales transaction (A. 493, 494).

Gale did not participate in any way in the following transactions:

(1) On October 23, 1964, Curry sold one share to Bastion for $300 cash (A. 493, 494).

(2) On December 4, 1964, he sold an additional share to Dick Bastion for $300 cash (A. 494).

(3) On January 4, 1965, he sold a third share to Dick Bastion for $300 cash (A. 494).

Curry was very prominent in tribal affairs. He knew the Ute Distribution Corporation owned minerals, land and possible future money claims against the United States Government. He was in financial need when he sold his stock (A. 494, 495).

11. STEWART EUGENE REED

On or about October, 1963, Mr. Reed sold five shares to Clyde L. Murray for an automobile and $300 cash. He executed a stock power and an affidavit and his signatures were respectively guaranteed and notarized by Gale. The Trial Court found that except as in these findings otherwise indicated, Gale did not participate in the sale transactions (A. 494-496).

On February 21, 1964, he sold five shares to Wallace A. Davis for an automobile and $700 cash. Gale did not participate in this transaction in any way (A. 495, 496).

12. RICHARD H. CURRY, SR.

On or about November 6, 1963, Mr. Curry sold five shares of stock to Clyde R. Murray for $500 a share. Gale quaranteed Curry's signature on the stock power. The Trial Court found that except as otherwise indicated, Gale did not participate in the sale negotiation and received nothing from the transaction (A. 497).

On or about September 2, 1964, Mr. Curry transferred three shares of stock to Richard Murray for $300 a share (A. 498).

On or about September 14, 1964, Mr. Curry transferred two shares to Gordon E. Harmston and Clara Mae Harmston

and his signature on the stock certificates was guaranteed by Gale. The Trial Court found that except as otherwise indicated Gale had nothing to do with the transaction (A. 497, 498).

ARGUMENT

I

THE CONDUCT OF GALE DID NOT VIOLATE RULE 10b-5

This Court must determine whether the actions of Gale, as outlined in the preceding sales transactions, violated Rule 10b-5.

Rule 10b-5 was adopted by the Securities and Exchange Commission of 1942 and is almost identical to Section 17 (a) of the Securities Act of 1933. It was designed to provide the Securities and Exchange Commission with a means of dealing with purchasers as well as sellers. See *Birnbaum v. New Port Steel Corp.* 193 F. 2d 461 (2d Cir. 1952), *cert. denied,* 343 U.S. 956 (1952). Rule 10b-5 is broken down into three clauses, which describe unlawful conduct. The Court of Appeals ruled that Gale did not violate any one of the three clauses. Petitioners argue that the decision of the Court of Appeals is wrong and that Gale violated all three clauses of Rule 10b-5.

An examination of Gale's participation in the sales of UDC stock by petitioners clearly shows why the Court of Appeals decided that Rule 10b-5 had not been violated.

(1) *Petitioners Did Not Prove a Scheme to Defraud*

The Court of Appeals after reviewing the entire record concluded:

> The record does not support the trial court's finding of a conspiracy, plan, or scheme to violate any duties owed to the plaintiffs by any of the defendants. The trial court was in error in so finding. (A. 586)

Petitioners point to the testimony of Richard Murray in an effort to show that profits on the resale of UDC stock were split with Gale and that such constitutes evidence of a scheme to defraud petitioners. The record, however, indicates some serious deficiencies in Murray's testimony. On cross examination Murray was not able to recall "any particular cases" where he split the commission with Gale (A. 120). In answer to a series of leading questions on redirect examination, Murray testified he had split the profit with Gale on the resale of the UDC stock to Frost, Jasper, Vannoy, Phelps, and Carpenter (A. 126). However, upon recross examination, Murray testified that Gale did not make any money on the resale of the Charles Hendricks stock to Frost or Jasper (A. 128) and he further stated that he was unable to recall how much the profit was, if any, which he split on the resale of stock to Vannoy. Gale testified that Mrs. Vannoy purchased all her stock directly and that he received no commission on it (A. 88). Murray did not know how much profit, if any, Gale made on the resale of shares to Carpenter. He then testified that he didn't know how much the profits were, if any, on any one of the transactions (A. 128, 129).

Gale testified that he did not split the profits with Murray or anyone else on the resale of any UDC stock (A. 64, 65, 76, 98).

It is the position of Gale that the Court of Appeals is correct for the reason that there is no evidence of any conspiracy, plan or scheme as required by Rule 10b-5. During 1963 and 1964 there were at least 33 persons acting independent of each other and in competition with one another who purchased stock from the mixed-bloods (A. 129). One of these persons was Robert Huish who purchased six shares of UDC stock from petitioner Joseph Arthur Workman for $3,000 (A. 489, 490). It is impossible to show any connection between Gale and Robert Huish or between Gale and any other person who purchased stock from the petitioners (A. 489, 490).

Convincing evidence of a lack of conspiracy, plan or scheme on the part of Gale is the fact that in the two transactions in which he was involved, both Mrs. Wopsock and Mr. Glen M. Reed sought out Gale and requested that he purchase their stock (A. 479, 480; 167 through 173).

(2) *Petitioners Failed to Prove Reliance.*

The Trial Court and the Court of Appeals found that there had been a misrepresentation and an omission to state a material fact by Gale in the transactions wherein he acquired five shares of UDC stock from Mrs. Wopsock and five shares from Glen M. Reed.

The Trial Court did not find that Mrs. Wopsock and Glen M. Reed sold their UDC stock to Gale in reliance upon the misrepresentation and omission of Gale (A. 586). It was due to this failure to prove reliance that the Court of Appeals ruled that petitioners had failed to prove a causal connection between the misrepresentation and the damages sustained by them.

The Court of Appeals properly recognized that petitioners' action is not based on common law fraud or deceit but is more properly to be classified as a tort arising from the violation of a criminal statute. Rule 10b-5 itself does not provide for civil liability if it is violated but the courts have interpreted the Rule as "implying" civil liability. The first court decision so implying civil liability under Rule 10b-5 was the case of *Kardon v. National Gypsum Co.* 69 F. Supp. 512 (E.D. Pa. 1946); 73 F. Supp. 798 (E.D. Pa. 1947). In that case Judge Kirkpatrick, in denying a motion of the defendants to dismiss, said:

> It is not; and cannot be, questioned that the complaint sets forth conduct on the part of the Slavins directly in violation of the provisions of Sec. 10(b) of the Act and of Rule [10b-5] which implements it. It is

also true that there is no provision in Sec. 10 or elsewhere expressly allowing civil suits by persons injured as a result of violation of Sec. 10 or of the Rule. However, "The violation of a legislative enactment by doing a prohibited act, or by failing to do a required act, makes the actor liable for an invasion of an interest of another if; (a) the intent of the enactment is exclusively or in part to protect an interest of the other as an individual; and (b) the interest invaded is one which the enactment is intended to protect. . . ." Restatement, Torts, Vol. 2, Sec. 286. This rule is more than merely a canon of statutory interpretation. The disregard of the command of a statute is a wrongful act and a tort. As was said in Texas & Pacific R. Co. v. Rigsby, 241 U.S. 33, 39, "This is but an application of the maxim, Ubi jus ibi remedium."

Of course, the legislature may withhold from parties injured the right to recover damages arising by reason of violation of a statute but the right is so fundamental and so deeply ingrained in the law that where it is not expressly denied the intention to withhold it should appear very clearly and plainly. The defendants argue that such intention can be deduced from the fact that three other sections of the statute (Sections 9, 16 and 18) each declaring certain types of conduct illegal, all expressly provide for a civil action by a person inured and for incidents and limitations of it, whereas Sec. 10 does not. The argument is not without force. Were the whole question one of statutory interpretation it might be convincing, but the question is only partly such. It is whether an intention can be implied to deny a remedy and to wipe out a liability which, normally, by virtue of basic principles of tort law accompanies the doing of the prohibited act. Where, as here, the whole statute discloses a broad purpose to regulate securities transactions of all kinds and, as a part of such regulation, the specific section in question provides for the elimination of all manipulative or deceptive methods in such transactions, the construction contended for by the defendants may not be adopted. In other words, in view of the general purpose of the Act, the mere omission of an express

provision for civil liability is not sufficient to negative what the general law implies.

The so-called "Tort Theory" set forth in the *Kardon* case rests upon the premise that where a legislative enactment contains no express liability provision a court may adopt that enactment as the standard of conduct which must be met in order to avoid liability or negligence. Restatement (Second) of Torts, 285-286 (1968) 63 Nw. U. L. Rev. 430, Bromberg, Securities Law: Fraud – SEC Rule 10b-5 §§ 8.6 and 2.4.

Inasmuch as petitioners' action is based in tort, the Court of Appeals ruled that petitioners had the burden of proving the elements thereof which are 1) a material misrepresentation or omission, 2) reliance, 3) damages. Judge Seth speaking for the Court of Appeals stated:

> In the case before us the facts of misrepresentation have been shown as to several of the transactions. The record, however, does not contain any evidence relating to reliance by the plaintiffs on the representations of the defendants Gale and Haslem. This is a necessary element of the cause alleged. List v. Fashion Park, Inc. 340 F. 2d 457 (2d Cir.), considers, defines, and requires both materiality of the representation and reliance. See also 16 U.C.L.A. Rev. 404; 63 Nw. U.L. Rev. 434. The plaintiffs allege that certain acts and statements of the defendants were directed to them or were the proximate cause of their damages. Thus the causal connection must be established – that in fact the loss resulted from defendants' acts – a simple and fundamental proposition in such actions for private damages. The plaintiffs' argument refers to several cases where the proceedings were brought by the SEC for enforcement. The matter of reliance was not there considered, but these are from an entirely different position (A. 586).

The Court of Appeals is supported by the decision of the 2nd Circuit, *List v. Fashion Park, Inc.*, 340 F. 2d 457 (2d Cir. 1965):

> This interpretation of Rule 10b-5 is a reasonable one, for the aim of the rule in cases such as this is to qualify, as between insiders and outsiders, the doctrine of *Caveat emptor* not to establish a scheme of investors' insurance. Assuredly, to abandon the requirement of reliance would be to facilitate outsiders; proof of insiders' fraud, and to that extent the interpretation for which plaintiff contends might advance the purposes of Rule 10b-5. But this strikes us as an inadequate reason for reading out of the rule so basic an element of tort law as the principle of causation in fact. . . .
>
> The proper test is whether the plaintiff would have been influenced to act differently then he did if the defendant had disclosed to him the undisclosed fact. Speed v. Transamerica Corp., 99 F. Supp. 808, 829; Kardon v. National Gypsum Co., 73 F. Supp. 798, 800 (E.D. Pa. 1947). To put the matter conversely, insiders are not required to search out details that presumably would not influence the person's judgment with whom they are dealing. Kohler v. Kohler Co., supra, 319 F. 2d at 642. This test preserves the common law parallel between 'reliance' and 'materiality' under Rule 10b-5 solely by substituting the individual plaintiff for the reasonable man. Of course this test is not utterly dissimilar from the one hinted at by the Trial Court. That the outsider did not have in mind the negative of the fact undisclosed to him, or that he did not put his trust in the advice of the insider, would tend to prove that he would not have been influenced by the undisclosed fact even if the insider had disclosed it to him.

The 1st Circuit has also held that reliance is essential in a violation of Rule 10b-5. *Janigan v. Taylor,* 344 F. 2d 781 (1st Cir. 1965), *cert. denied,* 828 U.S. 879 (1965).

> The defendant argues that the Court made no finding that the plaintiffs relied on the defendant's misprepresentations. Under any, interpretation of the Act this is a necessary condition.

It is to be noted that clauses (1) and (3) of Rule 10b-5 make no reference to reliance. Clause (2), however, in addition to requiring that the misrepresentation or omission be material provides that it must be considered "in light of circumstances under which they were made, not misleading." These words indicate that reliance upon the misrepresentation is necessary to prove a violation of Rule 10b-5 and that the Court must review the misrepresentation in light of the circumstance under which they were made to determine whether or not they were misleading.

In the instant case the Trial Court found that:

> In all transfers of the Ute Distribution Corporation stock made prior to August 27, 1964, the plaintiffs delivered an Offer to Sell, made in writing, to the Uintah and Ouray Agency of the Bureau of Indian Affairs at Fort Duchesne, Utah, for the purpose of offering said stock to the Ute Indian Tribe and its members. Each offer to sell set forth the number of shares to be sold and the amount the seller would accept for the stock. In each instance, the Offer to Sell was posted by Agency personnel in at least six public places on the Indian Reservation. None of these Offers to Sell was accepted by the Tribe or a member thereof. After the offers had been posted for a period of 30 days, the Superintendent of the Uintah and Ouray Agency sent a letter of notification to each person who had offered his stock for sale. The notification stated, in each instance, that no acceptance of the Offer to Sell had been made by the Ute Indian Tribe or a member thereof. It set forth the procedure to be followed under the regulations when the stock was to be sold to another person (A. 471-472).

The Court of Appeals considered the foregoing facts and determined that in light of the circumstances under which Gale misrepresented the prevailing market price, said misrepresentation was not misleading. The soundness of this decision is obvious. The price at which Gale purchased the UDC stock was

known to all who cared to observe for it was posted in at least six public places in Uintah and Duchesne Counties for a period of thirty days. It was in fact offered to any member of the Ute Indian Tribe or to the Ute Indian Tribe itself at the same price Gale was willing to pay, which offer could have been accepted by any one of the members of the Ute Indian Tribe. When the full blood Indians failed to accept the offer, Gale purchased the stock at the advertised price.

Gale purchased ten shares of UDC stock from two of the petitioners both of whom came to him and asked if he would buy their stock. There is no evidence that Gale pressured them to sell their stock or tried to take advantage of them.

Neither of the petitioners from whom Gale bought UDC stock relied upon the price Gale offered. Letha Harris Wopsock had independent knowledge of the value of the stock because she had sold two of her shares earlier to one Bill Hoopes for $700 a share (A. 479). Mrs. Wopsock had talked to Mrs. Logan at the Uintah Ouray Agency who advised her that the stock had a value in excess of $700 a share (A. 481). Yet, she sold four shares to Gale for $350 a share and one share for $400 (A. 479, 480).

Glen M. Reed asked Gale what he would pay for five shares of UDC stock. Gale told him he would pay him $1,750. Mr. Reed said he needed a little more and so Gale told him to seek Nick Murray because he might give him a higher price for his stock. Reed testified that he thought the stock was worth $500 a share but he decided to sell it to Gale for $350 per share (A. 167-173).

It was upon these facts that the Court of Appeals found that there had been a material misrepresentation of the prevailing market price by Gale but no reliance upon the misrepresentation by petitioners.

Petitioners argue that the Court of Appeals "severely restricted" Rule 10b-5 by requiring some participation by Gale. It must be remembered that the facts surrounding each of the sales made by the petitioners reveal completely isolated factual settings. As to all other sales made by the petitioners, Gale merely notarized and guaranteed their signatures. He made no representations to them but only performed the requested service. In light of this, the Court of Appeals correctly held that:

> The participation by the defendant Gale in the execution of documents as shown by the record in connection with these sales cannot constitute a breach of duty on his part to any of the plaintiffs (A. 584).

The scope of Rule 10b-5 does not extend to the point that the misstatement of the prevailing market price to one will permit a third person who was not even aware of the misstatement to recover damages. A. Bromberg, Securities Law: Fraud, S.E.C. Rule 10b-5 § 8.5 (1969). Yet the petitioners would have this Court extend the scope of Rule 10b-5 to this ridiculous limit by eliminating any causal connection between the misrepresentation and the damages. In support of their proposition, petitioners cite this Court's decision in *S.E.C. v. Capital Gains Research Bureau, Inc.* 374 U.S. 180 (1963). In that case this Court was reviewing a suit for a preliminary injunction not a suit for damages as in the instant case and it was upon this important distinction that this Court made its decision.

> The conclusion, moreover is not in derogation of the common law of fraud, as the District Court and the majority of the Court of Appeals suggested. To the contrary, it finds supports in the process by which the Courts have adopted the common law of fraud to the commercial transactions of our society. It is true that at common law, intent and injury have been deemed essential elements in a damage suit between the parties to an arms-length transaction. *But this is not such an action. This is a suit for a preliminary injunction* in which the

relief sought is as the dissenting judges below characterized it, the "mild prophylactic" 306 F. 2d at 613, of requiring a fiduciary to disclose to his clients, not all his security holding but only his dealings in recommended securities just before and after the issuance of his recommendations.

> The content of common-law fraud has not remained static as the Courts below seem to have assumed. It has varied, for example, with the nature of the relief sought, the relationship between the parties, and the merchandise in issue. *It is not necessary in a suit for equitable or prophylactic relief to establish all the elements required in a suit for monetary damages.* (Emphasis added)

The instant case is not a class action under Rule 23 of the Federal Rules of Civil Procedure but is a case involving permissive joinder of parties under Rule 20 (a) (A 4). Accordingly, each of the petitioners must prove a separate cause of action against the respondents. If one of the petitioners proves his case, that is not sufficient to permit all of the petitioners to recover damages. The facts and the law do not justify peitioners' contention that Gale is jointly and severally liable to all who sold UDC stock when Gale dealt with only two of the twelve petitioners.

The petitioners argue that the Court of Appeals was in error by not finding that Rule 10b-5 had been violated by Gale because the Bank withheld from petitioners the stock certificates which bore on their face a printed "Warning" (Ex. 101, A. 106). The stock certificates were retained by the Bank for safekeeping, a decision which Gale did not make and had absolutely no authority to change (A. 512).

The Court of Appeals was cognizant of the findings of the Trial Court on this point which findings were as follows:

> First Security Bank took the position, at all times

> prior to August 27, 1964, that it was entitled to keep and retain the Ute Distribution Corporation stock certificate owned by all of the mixed-bloods and did so until they were transferred or until after August 27, 1964. The proof is insufficient to show that this in and of itself was the direct cause of damage in any particular case and the evidence indicates that the retention system was established in good faith for convenience and in the supposed interest of the Indians; but it did minimize the dissemination of warnings against the disposal of stock and encourage acquisitions of stock from half-bloods without the 'warnings' being impressed upon them (A. 516).

While petitioners contend that the Court of Appeals erred in following these findings of fact, they have not presented any evidence nor given any reason to show error was committed.

(3) *Petitioners Failed to Prove a Fraudulent Course of Business*

Petitioners contend that clause (3) of Rule 10b-5 was violated by Gale notarizing false affidavits, Gale's abuse of inside information, and because Gale was an unregistered broker.

Nothing more needs to be said regarding the contention that Clause (3) was violated by "notarizing false affidavits" than was said by Judge Seth in the decision of the Court of Appeals:

> It would appear that the Trial Court places considerable reliance in reaching its conclusion on the asserted inaccuracies in the affidavits executed by the plaintiffs concerning their ultimate sales of the shares. However, the bank or the Government had no duty as to these plaintiffs to see that they executed affidavits that reflected the true transaction. Furthermore, the affidavits were executed in connection with the right of refusal in which, as indicated above, the defendants had no interest. It is difficult to see how they can complain of inaccuracies in their own affidavits (A. 583).

Petitioners' claim that Gale abused inside information is simply not supported by the evidence. The Trial Court found that Gale had "inside information . . . beyond that generally available to the plaintiffs" but it is difficult to tell from the findings whether the "inside information" was regarding the corporations affairs or the personal financial records of the stockholders of UDC (App. 521). Be that as it may, the Trail Court did not find that Gale used the "inside information" he had to deprive or cheat any of the petitioners. Rule 10b-5 was designed to prevent those having inside information from taking advantage of minority stockholders, which Gale did not do. See *Speed v. Transamerica Corporation* 99 F. Supp. 808, 828, 829 (D. Del. 1945), aff'd, 235 F. 2d 369 (3rd Cir. 1956).

The final argument that clause (3) of Rule 10b-5 was violated is based upon the assumption that Gale was an unregistered broker. It is argued that Gale should be liable under Rule 10b-5 because if he had been a registered broker his actions would have violated § 15 (c) (1) of the Security and Exchange Act of 1934, 15 U.S.C. § 78o (c) (1) (1964), and the regulations thereunder.

Does the purchase of ten shares of stock from two of the people and the reselling of eight shares to two people make Gale an unregistered broker? This is an issue which was never considered by either the Trial Court or the Court of Appeals and cannot be considered for the first time in this appeal.

It should also be noted that contrary to the position of petitioners, the term "broker" as defined in the Seourities and Exchange Act of 1934, Section 3(a) (4), excludes banks, 15 U.S.C. 78c (a) (4) (1964).

II

THE MEASURE OF DAMAGES IN A CIVIL ACTION FOR VIOLATION OF RULE 10b-5

There are relatively few cases which have reached the issue of damages for violation of Rule 10b-5. Most of the courts that have awarded damages have used the constructive trust approach which permits the seller to recover whatever profits the buyer realized on the resale of the stock. See *Kardon v. National Gypsum Co.*, 73 F. Supp. 798 (E. D. Pa. 1947); *Speed v. Transamerica Corp.*, 135 F. Supp. 176 (N. Del. 1955), *aff'd* with modification as to interest, 235 F. 2d 369 (3rd Cir. 1956): *Janigan v. Taylor*, 344 F. 2d 781, 786 (1st Cir. 1965), *cert. denied*, 382 U.S. 879 (1965).

The Court of Appeals acknowledged the prevailing market value of the UDC stock and followed the constructive trust approach:

> The measure of damages has been referred to above briefly. We hold that the trial court was in error in using the value of $1500 per share in the computation of damages as the evidence does not support such a figure. Also the evidence does not support the finding that the market price was depressed by the defendants. As to the cross-appeals, the evidence as to greater values was entirely speculative, as the trial court concluded.
>
> The measure of damages for breaches of duty under regulation 10b-5 is the profit made by the defendant on resale of stock purchased from the plaintiffs. If no resale was made or if the resale was not at arms length, then the measure is the prevailing market price at the time of the purchase from the plaintiffs (A. 587).

Section 28(a) of the Securities and Exchange Act of 1934, 15 U.S.C. Sec. 78bb(a) limits recovery in a civil action to "ac-

tual damages." The Court of Appeals in *Estate Counseling Service v. Merrill Lynch Pierce etc.*, 303 F. 2d 527 (10th Cir. 1962) defined actual damages as follows:

> "The failure to show actual damages is also a fatal defect in the cause of action based on the Securities Act of 1934, 15 U.S.C.A. 78a, et seq. That act permits recovery of his actual damages on account of the act complained of. "Actual damages," under the federal rule of damages for fraud is the "out of pocket rule." In the federal courts the measure of damages recoverable by one who through fraud or misrepresentation has been induced to purchase bonds of corporation stock is the difference between the contract price, or the price paid, and the real or actual value at the date of the sale, together with such outlays as are attributable to the defendant's conduct. Or, in other words, the difference between the amount parted with and the value of the thing received. (Cases cited by the Court have been omitted.)

The Seventh Circuit in *Kohler v. Kohler Co.* 208 F. Supp. 808 (E. D. Wis. 1962), *aff'd*, 319 F. 2d 635 (1963) ruled that the measure of damages under Rule 10b-5 was the difference between the price received by the plaintiff and the real or actual value of the stock at the date of the sale.

In the instant case the Trial Court found that from 1963 to 1965 UDC stock was being sold at prices ranging from $300 to $700 per share (A. 529) but then ruled that the reasonable and fair value of the stock during that period was $1500 per share (A. 537).

There is no evidence to support the finding of the Trial Court that the market price was $1500 per share. To the contrary the evidence clearly shows that Gale, whom the Trial Court found to have "inside information", received a maximum of $530 per share. To allow petitioners to recover $1500 a share

places them in a better position than they would have been if the alleged violation of Rule 10b-5 had not occurred.

Inasmuch as the record fails to show a market value in excess of $700 per share for UDC stock, to award petitioners damages based on a $1500 per share figure as urged by petitioners would allow punitive damages to be affixed against Gale contrary to 15 USC Sec. 78bb(a), *Myzel v. Fields*, 386 F. 2d 718, 748 (8th Cir. 1967); *Meisel v. North Jersey Trust Co. of Ridgewood*, N.J., 216 F. Supp. 469 (S.D.N.Y. 1963), or permit petitioners to recover the "expectant fruits of an unrealized speculation" contrary to the decision of this Court in *Smith v. Bolles*, 132 U.S. 125, 130 (1889).

The Trial Court ruled that the market value of the UDC stock had been influenced by Gale, Haslem and the Government (A. 529). It is difficult to understand this ruling in light of the finding that Gale and Haslem had only purchased 8-1/3% of the shares of UDC stock which was sold during the period in question. The balance, 91-2/3%, was purchased by 32 other individuals (A. 523).

No evidence was introduced at the trial which established the market value of the stock at $1500 per share, however, the Trial Court arbitrarily placed a value of $1500 on each share. This value was properly rejected by the Court of Appeals because the record contained nothing to support it.

The petitioners cite the following eminent domain cases in support of the $1500 valuation: *United States v. Silver Queen Mining Co.*, 285 F. 2d 506 (10th Cir. 1960), *United States v. Sowards*, 339 F. 2d 401 (10th Cir. 1964) and *Montana Railway Co. v. Warren*, 137 U.S. 348, 352 (1890). These cases give no support to the ruling of the Trial Court for under the law of eminent domain the value is "the equivalent of the fair market value of the property measured by what a willing buyer would

pay to a willing seller when neither is acting under compulsion." *United States v. Silver Queen Mining Co., supra.*

The value of $28,000 urged by the petitioners as the asset value of the UDC stock is so speculative that neither the Trial Court nor the Court of Appeals considered it. Its speculative nature is illustrated by the testimony of the petitioners' own expert witness that the "oil shale isn't worth four cents – until the process has been developed economically, and it will take millions of dollars to do this." Yet, petitioners contend that this same oil shale has a value of $414,150,000 (A. 375).

As was stated in *United States v. Bolles, supra,* damages do not include "the expectant fruits of an unrealized speculation."

CONCLUSION

The questions presented in this case relating to Rule 10b-5 are of first impression to this Court, however, the unanimous decision of the Court of Appeals on these questions is in harmony with the large body of case law that has developed in the area of Rule 10b-5 over the past 25 years.

In reaching its decision the Court of Appeals correctly analyzed the facts and decided that the performance of ministerial services is not participation in sales transactions and, therefore, not a violation of Rule 10b-5. It also established that unless there is reliance upon a misrepresentation of a material fact and a casual relation between the misrepresentation and the damages claimed there can be no recovery. Further, the decision correctly upholds 15 U.S.C. § 78bb (a) which limits damages to the amount actually suffered and refuses to allow a person to be placed in a better position than if the law had not been violated.

In light of the foregoing, Gale urges that the decision of the Court of Appeals be affirmed by this Court.

Respectfully submitted,

RICHARD CLARE CAHOON and
THOMAS R. BLONQUIST
640 Kennecott Building
Salt Lake City, Utah 84111

Attorneys for Respondent
John B. Gale